

<u>Report Date</u>	<u>Applicant</u>	<u>Conclusion</u>	<u>Potential Fund Recovery</u>
11/06/03	Santa Fe Indian School	Compliant	\$0
01/07/04	Navajo Preparatory Academy	Not Compliant	2,084,399

We have also established a working relationship with the Office of Inspector General at the Education Department (Education OIG). In January 2004, Education OIG presented a plan for an audit of telecommunication services at the New York City Department of Education (NYCDOE). Because of the significant amount of E-rate funding for telecommunication services at NYCDOE, Education OIG has proposed that they be reimbursed for this audit under a three-way MOU similar to the existing MOU with DOI OIG. In April 2004, the Universal Service Board of Directors approved the MOU. In June 2004, the MOU was signed and the audit was initiated.

#### Review of USAC Audits

We have reviewed work performed by USAC's Internal Audit Division and performed the procedures necessary under our audit standards to rely on that work. In December 2002, USAC established a contract with a public accounting firm to perform agreed-upon procedures at a sample of seventy-nine (79) beneficiaries from funding year 2000. The sample of beneficiaries was selected by the OIG. In a departure from the two previous large-scale rounds of E-rate beneficiary audits conducted by USAC contractors, the agreed-upon procedures being performed under this contract would be performed in accordance with both the Attestation Standards established by the American Institute of Certified Public Accountants (AICPA) Standards and Generally Accepted Government

Auditing Standards, issued by the Comptroller General (GAGAS or "Yellow Book" standards). In March 2003, we signed a contract with a public accounting firm to *provide audit support services for USF oversight to the OIG*. The first task order that we established under this contract was for the performance of those procedures necessary under "Yellow Book" standards to determine the degree to which we can rely on the results of that work (i.e., to verify that the work was performed in accordance with the AICPA and GAGAS standards). Many of the audit findings raised by this body of work are reflected in the section addressing concerns with the E-rate program.

#### Support to Investigations

In addition to conducting audits, we are providing audit support to a number of investigations of E-rate recipients and service providers. To implement the investigative component of our plan, we established a working relationship with the Antitrust Division of the Department of Justice (DOJ). The Antitrust Division has established a task force to conduct USF investigations comprised of attorneys in each of the Antitrust Division's seven (7) field offices and the National Criminal Office. We are also supporting several investigations being conducted by Assistant United States Attorneys.

We are currently supporting seventeen (17) investigations and monitoring an additional fifteen (15) investigations. Allegations being investigated in these cases include the following:

- Procurement irregularities – including lack of a competitive process and bid rigging;

- False Claims – Service Providers billing for goods and services not provided;
- Ineligible items being funded; and
- Beneficiaries not paying the local portion of the costs resulting in inflated costs for goods and services to the program and potential kickback issues.

In the past year, there have been a number of significant law enforcement actions involving the E-rate program:

- In May 2004, NEC-Business Network Solutions Inc. (NEC/BNS) pled guilty and agreed to pay a total \$20.6 million criminal fine, civil settlement and restitution relating to charges of collusion and wire fraud involving the E-rate program. NEC/BNS was charged with allocating contracts and rigging bids for E-Rate projects at five different school districts in Michigan, Wisconsin, Arkansas, and South Carolina, in violation of the Sherman Antitrust Act. NEC/BNS was also charged with wire fraud by entering into a scheme to defraud the E-Rate program and the San Francisco Unified School District by inflating bids, agreeing to submit false and fraudulent documents to hide the fact that it planned on installing ineligible items, agreeing to donate “free” items that it planned to bill E-rate for, and submitting false and fraudulent documents to defeat inquiry into the legitimacy of the funding request. In May 2004, NEC/BNS filed a petition for waiver of program suspension and debarment rules. In July 2004, the Commission sought comment on NEC/BNS’s petition for waiver. The Commission has not taken action on NEC/BNS’s petition.

- In December 2004, Inter-Tel Technologies Inc. pled guilty and agreed to pay a total of \$8.71 million in criminal fines, civil settlement, and restitution relating to charges of bid rigging and wire fraud in connection with the E-Rate program. Inter-Tel was charged with one count of allocating contracts and submitting rigged bids for E-Rate projects at two different school districts in Michigan and California. Inter-Tel also was charged with one count of wire fraud and aiding and abetting by willfully entering into a scheme to defraud the E-Rate program in San Francisco by inflating bids, agreeing to submit false and fraudulent documents to hide the planned installation of ineligible items, and submitting false and fraudulent documents to defeat inquiry into the legitimacy of the funding request. In January 2005, Inter-Tel received a notice of suspension and of proposed debarment from the E-rate program. The NEC/BNS and Inter-Tel cases are part of a large, on-going investigation.
- In October 2004, Qasim Bokhari and Haider Bokhari pled guilty to charges of conspiracy, fraud, and money laundering involving the E-rate program. According to court papers, in 2001, Qasim Bokhari and his company submitted applications for E-Rate Program funding on behalf of 21 schools in the Milwaukee and Chicago areas totaling more than \$16 million. Qasim Bokhari and his company eventually received more than \$1.2 million for goods and services that were not provided to three of these schools. Additionally, according to the charges, Qasim Bokhari, Haider Bokhari, and Raza Bokhari conspired to conduct numerous financial transactions involving the proceeds of the fraud to conceal and disguise the source of the proceeds. These alleged financial transactions include wiring more than \$600,000 to Pakistan, purchasing a residence, and acquiring several automobiles. In January 2005, Qasim

Bokhari and Haider Bokhari were each sentenced to six-year prison terms. In

*February 2005, Qasim Bokhari and Haider Bokhari received notices of suspension and proposed debarment from the E-rate program.*

### **Concerns with the E-rate Program**

OIG involvement in E-rate audits and investigations has highlighted numerous concerns with this program. These include general programmatic and management concerns as well as specific concerns related to program design. General concerns include:

- lack of clarity regarding program rules, and;
- lack of timely and effective resolution of audit findings.

Specific concerns regarding program design include;

- weaknesses in program competitive procurement requirements;
- ineffective use of purchased goods and services;
- over-reliance on certifications;
- weaknesses in technology planning; and
- issues relating to discount calculation and payment.

#### *Lack of Clarity Regarding Program Rules*

Under Commission staff oversight, USAC has implemented numerous policies and procedures to administer the E-rate program. In some cases, the Commission has adopted these USAC operating procedures, in other cases however, USAC procedures have not been formally adopted by the FCC. In those cases where USAC implementing

procedures have not been formally adopted by the Commission, it is the position of Commission staff that there is no legal basis for recovery of funds when applicants fail to comply with these procedures. To further complicate matters, we have been advised that, in some cases, USAC may have exceeded their authority in establishing program requirements. We are concerned about the distinction that Commission staff makes between program rules and USAC implementing procedures for a number of reasons.

- First, we believe that this distinction represents a weakness in program design. Within their authority under program rules, USAC has established implementing procedures to ensure that program beneficiaries comply with program rules and that the objectives of the program are met. In those cases where USAC has established implementing procedures that are not supported by program rules, USAC and the Commission have no mechanism for enforcing beneficiary compliance.
- Second, we believe that it is critical that participants in the E-rate program have a clear understanding of the rules governing the program and the consequences that exist if they fail to comply with those rules. We do not believe that it is possible under the current structure for applicants to have a clear understanding of program rules. We are concerned that the Commission has not determined the consequences of beneficiary non-compliance in many cases and that, in those instances where the Commission has addressed the issue of consequences for non-compliance, the consequences associated with clear violations of program rules do not appear to be consistent.

- *Third, a clear understanding of the distinction between program rules and USAC implementing procedures is necessary for the design and implementation of effective oversight. It is necessary for the timely completion of audits and the timely resolution of audit findings and implementation of corrective action resulting from audits. This matter is further complicated by the Commission's position that USAC may have exceeded their authority in establishing some of the implementing procedures. As a result, we have determined that it is necessary, as part of the E-rate beneficiary audit process, to examine USAC authority for establishing procedures for which we are evaluating beneficiary compliance.*

*Lack of Timely and Effective Resolution of Audit Findings from E-rate Beneficiary Audits*

Since our involvement in this program, I have become increasingly concerned about efforts to resolve audit findings and to recover funds resulting from E-rate beneficiary audits. It has been our observation that audit findings are not being resolved in a timely manner and that, as a result, actions to recover inappropriately disbursed funds are not being taken in a timely manner. In some cases, it appears that audit findings are not being resolved because USAC is not taking action in a timely manner. In other cases, findings are not being resolved because USAC is not receiving guidance from the Commission that is necessary to resolve findings. USAC is prohibited under program rules from making policy, interpreting unclear provisions of the statute or rules, or interpreting the intent of Congress. As a result of this prohibition, USAC must seek

guidance from the Commission when audit findings are not clearly violations of Commission rules.

The second large-scale audit of E-rate beneficiaries was conducted by the public accounting firm of Arthur Andersen under contract to USAC. In 2001, USAC contracted with Arthur Andersen to conduct audits at twenty-five (25) beneficiaries from funding years 1999 and 2000. E-rate disbursements to these beneficiaries totaled \$322 million. Arthur Andersen provided a draft audit report summarizing the results of these audits on May 31, 2002. The final report, including responses from the USAC Schools and Libraries Division, was released by the Schools and Libraries Committee of the USAC Board of Directors on April 23, 2003, eleven months after the draft report was provided by Arthur Andersen. The audit report disclosed monetary findings at fourteen (14) of the twenty-five (25) beneficiaries including \$11.4 million dollars in inappropriate disbursements and unsupported costs. As of September 30, 2003, USAC had recovered \$1,927,579 in inappropriate disbursements and unsupported costs and initiated recovery actions for another \$1,353,741, of which \$709,013 is under appeal. We have been advised that USAC initiated recovery actions for the remaining \$8,059,141.

The final report adopted by the Universal Service Board also identified eleven (11) policy issues, relating to thirty-three (33) separate findings, for which USAC determined that FCC policy guidance was required. The dollar value of potential fund recoveries associated with these thirty-three (33) findings was not available because, in most cases, the final report indicated that those amounts had not been determined. Policy issues



identified included the lack of fixed asset and associated records, maintenance of connectivity once it is established, technology plan approver control and requirements, insufficient documentation including lack of invoice detail and vendor payment information, incomplete or insufficient competitive bidding documentation, monitoring of technology plan goals and objectives, and physical security of equipment. Although the final report was released on April 23, 2003, USAC did not request policy guidance from Commission staff until October 2003. In January 2004, Commission staff provided "informal" guidance to USAC related to E-rate beneficiary audits being conducted by KPMG. These informal comments included reference to four (4) of the eleven (11) Arthur Anderson round 2 policy questions raised by USAC in their October 2003 request. On March 4, 2004, Commission staff provided guidance to USAC on the eleven (11) policy issues, almost two years after the draft report was submitted by Arthur Andersen. Many of the policy questions raised in USAC's request for guidance address issues identified in other audits including other E-rate beneficiary audits conducted by USAC's Internal Audit Division and those conducted by the FCC OIG.

#### Weaknesses in Program Competitive Procurement Requirements

Program rules require that applicants use a competitive procurement process to select vendors. In establishing this requirement, the Commission recognized that "(c)ompetitive bidding is the most efficient means for ensuring that eligible schools and libraries are informed about all of the choices available to them" and that "(a)bsent competitive bidding, prices charged to schools and libraries may be needlessly high, with the result that fewer eligible schools and libraries would be able to participate in the

program or the demand on universal service support mechanisms would be needlessly great.”

Applicants are required to submit a form 470 identifying the products and services needed to implement the technology plan. The form 470 is posted to the USAC web page to notify service providers that the applicant is seeking the products and services identified. Applicants must wait at least 28 days after the form 470 is posted to the web site and consider all bids they receive before selecting the service provider to provide the services desired. In addition, applicants must comply with all applicable state and local procurement rules and regulations and competitive bidding requirements. The form 470 cannot be completed by a service provider who will participate in the competitive process as a bidder and the applicant is responsible for ensuring an open, fair competitive process and selecting the most cost-effective provider of the desired services. Further, although no program rule establishes this requirement, applicants are encouraged by USAC to save all competing bids for services to be able to demonstrate that the bid chosen is the most cost-effective, with price being the primary consideration.

Although the programs competitive bidding requirements were intended to ensure that schools and libraries are informed about all of the choices available to them, we have observed numerous instances in which beneficiaries are not following the program’s competitive bidding requirements or are not able to demonstrate that competitive bidding requirements are being followed. We question whether the rules are adequate to ensure a competitive process is followed. In addition, weak recordkeeping requirements to support the procurement process, as well as other aspects of the E-rate application, offer

little protection to the program. We believe that the competitive procurement requirements are based on some faulty assumptions. For example,

- Form 470s will have enough information for meaningful proposals from prospective service providers.
- Service providers are reviewing and considering posted form 470s (particularly for smaller schools).
- “Applicable” state and local procurement regulations exist and those regulations are consistent with program rules.

#### Ineffective Use of Purchased Goods and Services

Site visits are conducted during most E-rate beneficiary audits. Site visits are conducted for several reasons including to evaluate the eligibility of facilities where equipment is installed, verify that equipment is installed and operational, and to verify that equipment is being used for its intended purpose. Examples of concerns identified during audits and investigations are as follows:

- Goods and services not being provided.
- Unauthorized substitution of goods and services.
- Goods and services being provided to ineligible facilities (e.g., non-instructional building including dormitories, cafeterias, and administrative facilities).
- Equipment not being installed or not operational. Program rules require that nonrecurring services be installed by a specified date. However, there is no specific

FCC rule requiring beneficiaries to use equipment in a particular way, or for a specified period of time, or to full efficiency. Commission staff have provided guidance stating that if the equipment was uninstalled (i.e., still in a box) that would represent a rule violation. However, Commission staff have also provided guidance stating that the rules do not require that beneficiaries effectively utilize the services provided or that the beneficiaries maintain continuous network or Internet connectivity once internal connections are installed.

#### Over-reliance on Certifications

The E-rate program is heavily reliant on applicant and service provider certifications. For example, on the form 470, applicants certify that the support received is conditional upon the ability of an applicant to secure access to all of the resources, including computers, training, software, maintenance, and electrical connections, necessary to use effectively the services that will be purchased under this mechanism. On the form 471, applicants make several important certifications. Applicants certify that they have "complied with all applicable state and local laws regarding procurement of services for which support is being sought" and that "the services that the applicant purchases ... will not be sold, resold, or transferred in consideration for money or any other thing of value." Other certifications are required on various program forms.

My office started to raise concerns about perceived weaknesses in the competitive procurement process and over reliance on certifications shortly after we became involved in program oversight. We first became concerned about the competitive procurement

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process as a result of our involvement in the Metropolitan Regional Education Service Agency (MRESA) investigation. During that investigation we observed how weaknesses in competitive bidding requirements and reliance on self certification were exploited resulting in, at a minimum, a significant amount of wasteful spending. We continued to express our concerns as we designed our oversight program, developed a program for auditing beneficiaries, and supported E-rate fraud investigations. In fact, we established a working relationship with the Antitrust Division of the Department of Justice in a large part because of the number of investigations that we were supporting that involved allegations regarding the competitive procurement process.

Our level of concern regarding both the competitive procurement process and reliance on self-certification was heightened as we started to work with the Antitrust Division. During our discussions with Antitrust, they expressed a general concern with the lack of information regarding the competitive process and specific concerns regarding applicant and service provider certifications. We started to pursue issues raised by the Antitrust Division with Commission staff in the fall of 2002. I am pleased to report today that the Commission has addressed many of the recommendations from Antitrust and is considering action on other recommendations.

#### Weaknesses in Technology Planning

Program rules require that applicants prepare a technology plan and that the technology plan be approved. The approved technology plan is supposed to include a sufficient level of information to justify and validate the purpose of a request for E-rate funding. USAC

*implementing procedures state that approved technology plans must establish the connections between the information technology and the professional development strategies, curriculum initiatives, and library objectives that will lead to improved education and library services. Although the technology plan is intended to serve as the basis for an application, we have observed many instances of non-compliance with program rules and USAC procedures related to the technology planning process. Examples of technology planning concerns identified during audits and investigations are as follows:*

- Technology plans are not being reviewed and approved in accordance with program rules.
- Technology plans do not address all required plan elements in accordance with USAC implementing procedures for technology planning. Commission staff has provided guidance that failure to comply with USAC implementing procedures for technology plans is not a rule violation and does not warrant recovery of funds. As part of the current round of beneficiary audits, we are attempting to determine if USAC had the authority to establish these requirements.
- Applicants not being able to provide documentation to support the review and approval of technology plan.

USAC guidance on technology planning states that “(i)n the event of an audit, you may be required to produce a certification similar to the SLD sample "Technology Plan Certification Form," in order to document approval of your technology plan.” Numerous

audits have included findings beneficiaries were unable to provide documentation to demonstrate the review and approval of technology plans. Although program rules require that applicants have a technology plan and that the plan be approved, the rules do not require that the applicant maintain specific documentation regarding the approval process.

#### Discount Calculation and Payment of the Non-Discount Portion

The E-rate program allows eligible schools and libraries to receive telecommunications services, Internet access, and internal connections at discounted rates. Discounts range from 20% to 90% of the costs of eligible services, depending on the level of poverty and the urban/rural status of the population served, and are based on the percentage of students eligible for free and reduced lunches under the National School Lunch Program (NSLP) and other approved alternative methods. A number of audits have identified audit findings that applicants have not followed program requirements for discount rate calculation or were unable to support the discount rate calculated.

Applicants are required to pay the non-discount portion of the cost of the goods and services to their service providers and service providers are required to bill applicants for the non-discount portion. The discount rate calculation and program requirement for payment of the non-discount portion are intended to ensure that recipients avoid unnecessary and wasteful expenditures and encourage schools to seek the best pre-discount rate. Examples of concerns identified during audits and investigations are as follows:

- Applicant not paying the non-discount portion;
- Applicant not paying the non-discount portion in a timely manner; and
- Service providers not billing recipients for the non-discount portion.

I am pleased to report that concerns that we have raised about the E-rate program have received considerable attention at the Commission. Most notably, on August 4, 2004, the Commission adopted the Fifth Report and Order on the Schools and Libraries Universal Service Support Mechanism. In the Fifth Report and Order, the Commission resolved a number of issues arising from audits of the E-rate program and programmatic concerns raised by my office. In the introduction to the Fifth Report and Order, the Commission included the following statement regarding actions taken in the order:

*First, we set forth a framework regarding what amounts should be recovered by the Universal Service Administrative Company (USAC or Administrator) and the Commission when funds have been disbursed in violation of specific statutory provisions and Commission rules. Second, we announce our policy regarding the timeframe in which USAC and the Commission will conduct audits or other investigations relating to use of E-rate funds. Third, we eliminate the current option to offset amounts disbursed in violation of the statute or a rule against other funding commitments. Fourth, we extend our red light rule previously adopted pursuant to the Debt Collection Improvement Act (DCIA) to bar beneficiaries or service providers from receiving additional benefits under the*



*schools and libraries program if they have failed to satisfy any outstanding obligation to repay monies into the fund. Fifth, we adopt a strengthened document retention requirement to enhance our ability to conduct all necessary oversight and provide a stronger enforcement tool for detecting statutory and rule violations. Sixth, we modify our current requirements regarding the timing, content and approval of technology plans. Seventh, we amend our beneficiary certification requirements to enhance our oversight and enforcement activities. Eighth, we direct USAC to submit a plan for timely audit resolution, and we delegate authority to the Chief of the Wireline Competition Bureau to resolve audit findings. Finally, we direct USAC to submit on an annual basis a list of all USAC administrative procedures to the Wireline Competition Bureau (Bureau) for review and further action, if necessary, to ensure that such procedures effectively serve our objective of preventing waste, fraud and abuse.*

#### **Update on OIG Oversight Activities**

As I discussed earlier in this testimony, the primary obstacle to implementation of effective, independent oversight has been a lack of adequate resources to conduct audits and provide audit support to investigations. This lack of resources has prevented us from completing the body of work necessary to assess fraud, waste, and abuse at the program level.

Since our initial involvement in independent oversight of the USF as part of our conduct

of the FY 1999 financial statement audit, we have added four (4) staff auditor positions *and organized USF oversight activities under an Assistant Inspector General for USF Oversight*. This represents dedication of five (5) of the ten (10) auditors on the staff of the FCC OIG to USF oversight. In addition to the OIG staff dedicated to USF oversight, two (2) audit staff members responsible for financial audit are also involved in USF oversight as part of the financial statement audit process. In January 2005, we were advised that the OIG would receive two (2) additional staff for USF oversight. We are in the process of hiring these additional staff.

We have also requested appropriated funding to obtain contract support for our USF oversight activities. In our FY 2004 budget submission, we requested \$2 million for USF oversight. That request was increased to \$3 million in the President's budget submission for FY 2004. This funding was not included in the Commission's final budget for FY 2004 and report language indicated that monies for USF audits should come from the fund itself.

Based largely on that report language, we began to explore alternatives for obtaining access to contract audit support to implement the USF oversight portions of our audit plan. We have been working with USAC since last summer to establish a three-way contract under which the OIG and USAC can obtain audit resources to conduct USF audits. Under this contract, we intend to conduct the body of audits necessary to assess fraud, waste, and abuse at the program level by conducting a statistically valid sample of audits for each of the four USF funding mechanisms. The objectives of the audits are to:

(1) detect waste, fraud, and abuse by beneficiaries of the universal service support mechanisms, (2) deter waste, fraud, and abuse by beneficiaries of the universal service support mechanisms, (3) generate insights about the compliance of beneficiaries with applicable law and the quality of administration of the universal service support mechanisms and (4) identify areas for improvement in the compliance of beneficiaries with applicable law and in the administration of the universal service mechanisms. An additional objective is to identify improper payments as defined by the Office of Management and Budget to estimate error rates for the Improper Payments Improvement Act of 2002 (IPIA). I am pleased today to report that we are close to selecting a public accounting firm, or firms, to provide support for our USF oversight activities, including E-rate audits and support to E-rate investigations. We released a Request for Proposal in November 2004 and expect to complete the selection process very soon.

We are also working with USAC and a public accounting firm under contract to USAC to conduct the fourth large-scale audit of E-rate beneficiaries. One-hundred beneficiaries are being audited as part of this project. The project was initiated in August 2004 and is expected to be completed next summer.

### **Conclusion**

The Office of Inspector General remains committed to meeting our responsibility for providing effective independent oversight of the USF and we believe we have made significant progress. While the Commission has taken steps to address programmatic

weaknesses, more work remains to be done. Through our participation in the fourth large-scale round of E-rate beneficiary audits with USAC and through audits that we anticipate conducting under our three-way agreement with USAC, we are moving forward to evaluate the state of the program and identify opportunities for programmatic improvements.